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UNCLAS SECTION 01 OF 02 BRASILIA 000531

SIPDIS

NSC FOR SHANNON, DEMPSEY, CRUZ
TREASURY FOR OASIA/SEGAL
EXIMBANK FOR DIRECTOR FOLEY
FED BOARD OF GOVERNORS FOR ROBATAILLE
USDA FOR U/S PENN, FAS/FAA/TERPSTRA
USDOC FOR 4322/ITA/IEP/WH/OLAC-SC
SOUTHCOM FOR POLAD
BUENOS AIRES ALSO FOR TREASURY ATTACHE

SENSITIVE

E.O. 12958: N/A
TAGS: EFIN ECON EINV ETRD PREL PGOV SOCI BR
SUBJECT: BRAZIL: EXTERNAL DEBT NOTES

REF: BRASILIA 0450

This cable is Sensitive but Unclassified, please protect accordingly.

¶1. (SBU) Summary: The GoB hopes to use current relatively positive market sentiment and stronger foreign exchange rates to quietly rebuild reserves. In contrast to very active reshaping of its domestic debt profile, the GoB has been fairly passive on external debt management. While the recent unprecedented rise in value of Brazil's C-bond has created the opportunity for the GoB to repurchase these instruments, this seems unlikely at a point where the GoB is trying to rebuild reserves. Meeting total public and private foreign amortizations of $43.9 billion in 2004 is not expected to be a problem. End Summary.

C-bonds

¶2. (U) Lula's success in reassuring international financial markets of the prudence of his macroeconomic policies has given Brazil new openings to tap international markets, as illustrated by its January 2004 30-year Eurobond issued at 377 basis points above U.S. Treasuries. This issuance was all the more remarkable since Brazilian bonds traded at spreads of 24% above U.S. Treasuries little over a year earlier. Despite this, the GoB does not plan significant net new foreign debt issuance, using new issues primarily to roll over maturing foreign debt to avoid drawing down reserves. The GoB has also been engaging in significant FX purchases to build reserves and smooth the exchange-rate effect of an April 2004 spike in foreign debt amortization.

¶3. (SBU) A Central Bank Director told Econoff February 19 that investment banks were pitching him on an almost daily basis with various schemes to buy back Brazil's benchmark C-bonds, the most liquid of Brazil's Brady bonds. The C-bonds, the product of an early 1990s' foreign-debt restructuring, reached 100% of their face value in February. This opened up the practical possibility of repurchasing all or part of the USD 6.5 billion in outstanding C-bonds. The CB Director explained that the GoB has the option of repurchasing these bonds at the time of their biannual coupon payments (April and October), but must announce its intention to do so during a thirty-day window beginning sixty days before the coupon payment date.

¶4. (SBU) The C-bonds have since dropped below 100% of face value, complicating any repurchase deal. The Central Bank Director noted in our February meeting, however, that it would not make much sense to attempt a repurchase on the scale required to redeem the C-bonds at a time when Brazil is trying to rebuild reserves. If the right deal to swap the C-bonds for new, cheaper debt presented itself, however, the GoB might well take it, our interlocutor said.

Amortizations for the Year

¶5. (U) Managing Brazil's foreign public debt in 2004 should not pose a challenge. The GoB has been working to manage the impact of this year's total $43.9 billion in public and private foreign debt amortizations on the exchange rate. The Finance Ministry is making use of a new rule that doubles to 180 days the horizon during which the Treasury may purchase foreign exchange for upcoming debt repayments. This allowed it to use stronger November and December exchange rates and lower seasonal foreign exchange demand to purchase dollars well in advance for the spike of public-debt amortizations of $4.3 billion in April.

Scheduled Foreign-Debt Amortization, 2004
(Billions of USD)

	Private	Public/1	Total
Jan	1.378	0.395	3.822
Feb	1.001	0.598	4.77
March	1.695	2.002	3.697
April	2.417	4.282	8.092
May	2.324	0.214	3.735
June	2.909	3.034	5.943
July	2.449	0.547	4.792
August	2.571	0.453	2.118
Sept	1.950	1.147	3.097
Oct	1.730	1.185	3.912
Nov	2.883	0.668	1.55
Dec	3.668	1.96	5.628
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Total	26.975	16.959	43.935

1/Includes IMF amortizations
Source: Central Bank and Ministry of Finance

¶6. (U) Combined with market expectations as of January 2004 of a current-account deficit of 0.5% of GDP ($2.55 bn) and total private and public debt amortization of $43.9 bn, Brazil's total external financing requirements this year are forecast at$46.49 bn. Officially, this financing need is to be met through expected foreign investment inflows of $11 bn, leaving $35.3 billion to be met through a combination of debt rollovers, potential net new issuances of external debt, use of reserves and purchases of dollars. Better than expected dollar inflows should reduce the financing need: net dollar inflows of $1.3 billion in February brought year to date inflows to $4.7 billion. To smooth its debt repayment in the longer term, the GoB agreed with the IMF at the time of the extension of its IMF agreement in November 2003 to delay by one year each of two repurchases of SDR 4 billion (about US$5.5 billion) arising in 2005 and 2006.

COMMENT

¶7. (SBU) While Brazil's overall debt profile is a continuing concern, its public foreign debt is in better shape, being of both longer term and lower interest rates than Real-denominated debt. Strong foreign-exchange inflows, primarily due to the continued surprisingly strong trade surplus, should continue to cushion foreign debt amortizations for both public and private debt.
VIRDEN